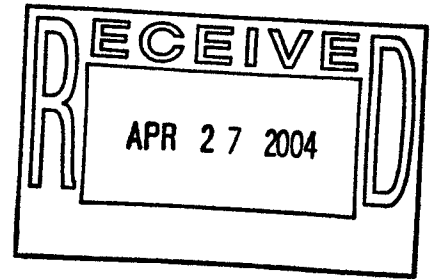




Mr. Paul B. Demetriades  
2254 Evergreen Point Rd.  
Medina, WA 98039



Mr. Armando Falcon  
Director, OFHEO

Fm: Paul B. Demetriades, <sup>PBD</sup>

Re: OFHEO Proposed Governance Rule  
News Release dtd April 7, 2004

Per ref. request for public comment I'm submitting following for incorporation/revision to the governance rule:

- "Limiting Directors to ten years of service & an age limit of 72"

- Limit is a good idea, but Directors should be nominated for 3-year terms. There should be several directors nominated by the public.

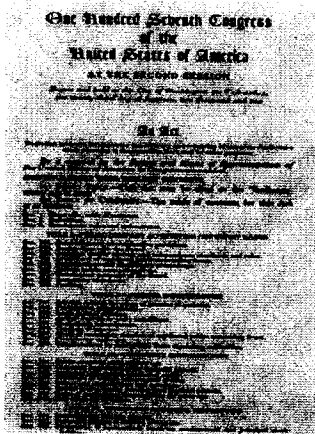
- "Requiring audit partner rotation every 5-years & auditor rotation every 10 years"

- The auditor/audit partner should be selected & report to the Audit Committee of the Board.

- The independent auditor's fees should be for audit; audit related (due diligence e.g.); & taxes. All other fees - general consulting should be strictly limited (set \$ limit) All fees to be pre-approved by Audit Committee.

See additl recommendations on page 3 of enclosed paper.

ENC.



January 26, 2004

**Sarbanes-Oxley Act of 2002  
Governance Applications in Business, Government,  
and Higher Education—Health Care**

by Paul B. Demitriades

**Introduction and Business Application**

The Sarbanes-Oxley Act of 2002 (hereinafter referred to as SOA) recently celebrated its one-year anniversary. Although specifically applicable to publicly traded companies, (their audit firms, lawyers, etc.) and those considering Initial Public Offerings, its principles are now being considered by governing boards of non-profits, colleges & universities and government entities. SOA principles are being considered by the European Union and rapidly becoming global best practices.

**The SOA is organized into 11 titles and supporting sections**

- Title I – Public Accounting Oversight Board
- Title II – Auditor Independence
- Title III – Corporate responsibility sec.302, sec.307
- Title IV – Enhanced Financial Disclosure sec. 404
- Title V – Analysts Conflicts of Interest
- Title VI – Commission Resources & Authority
- Title VII – Studies & Reports
- Title VIII – Corporate & Criminal Fraud Accountability
- Title IX – White Collar Crime Penalty Enhancements
- Title X – Corporate Tax Returns
- Title XI – Corporate Fraud Accountability

**The major provisions of the Act**

- Creates a 5-member Public Accounting Oversight Board to enforce profession standards, ethics and competence for accounting profession (appointed by Securities & Exchange Commission – SEC).
- Increases corporate responsibility for financial disclosure
- Protects objectivity and independence of financial security analysts
- Independence of auditors
- Penalties for corporate wrong-doing
- CEO's & CFO's required to personally vouch/certify truth & fairness of company disclosures
- Criminal sanctions to protect whistle-blowers and prohibit destruction of documents related to federal agency investigation

### **Section 302, 307 & 404 highlights**

Title III, Sections 302 & 307 and Title IV, Section 404 of the Act is an important foundation for restoring post-Enron, investor confidence in public financial reporting integrity.

Section 302 provides for CEO/CFO certification of annual financial statements.

Section 307 requires lawyers to notify directors if they have reported to the company, any material breach of securities law. If not satisfied with the company's response, section 307 also gives lawyers permission to notify the SEC of violations. According to media reports sec. 307 has been much debated by lawyers concerned about client attorney privilege. Section 404 specifies financial statement content and internal finance/accounting controls.

After two years of scandals on Wall Street, public companies and the mutual fund industry, the SEC, after a long period of dormancy, has been re-energized under the SOA. In 2004, an election year, the SEC, under its new chairman, an ex-NYSE CEO, and with a 25% boost in budget by Congress, will act on corporate governance issues. The SEC faces continued mutual fund reform pressure from several state Attorney Generals, especially Eliot Spitzer, New York State.

Readers interested in obtaining corporate governance and related party information on public companies should go the SEC web site [www.sec.gov](http://www.sec.gov) - see EDGAR (Form 10k's & proxy statements).

Several accounting firms and business associations have published SOA guides. As an example, Protiviti (a wholly owned subsidiary of RHI), is an independent internal audit/risk consulting firm, has publications that deserve SOA internal control reporting requirements. The guide to section 404 is useful. See updates at their web site [www.protiviti.com](http://www.protiviti.com)



## **SOA Application to Government**

Although SOA reforms are being applied in the private sector, federal, state & local governments should consider applicability, given the complexity of government finance. Professor Keith M. Bronner, University of Albany, NY, has written about SOA applicability to government. He has 4 recommendations:

1. Government should use different accounting firms to design managerial control systems and to conduct audits.
2. The CEO/CFO of each government should personally sign-off on financial statements.
3. The use of derivatives and all off-balance sheet transactions should be clearly outlined in financial statements/notes.
4. The legislative branch (city council, town board, or county legislature) should include at least one designated financial expert to help oversee the financial status of the government entity.

Several state governments are considering adoption of SOA provisions – some expanding on these provisions.

## **SOA Application to Higher Education – Health Care**

The National Association of College & University Business Officers (NACUBO) has been considering SOA applications for higher education institutions. The NACUBO Accounting Principles Council, with college/university auditors, several public accounting firms and other campus administrators, developed a set of recommendations published in an Advisory Report, dated Nov. 20, 2003 (4). This report includes an extensive checklist for higher education that evaluates the Act's eleven titles and sections and provides action recommendations for each. The full report/checklist is available at the NACUBO web site [www.nacubo.org](http://www.nacubo.org).

At the University of Washington, Seattle, WA, UW Medicine (including the Medical Center, Harborview Hospital, University of WA Physicians, etc.) is governed by an independent board, reporting to the state institutions' Board of Regents and recently voluntarily adopted a Resolution, developed by the UW Medicine Board's Compliance Committee, regarding SOA, as guidance for further action to operationalize its principles by the entities comprising UW Medicine. The Resolution focuses on audit firms/UW board committee responsibilities, employee orientation/training – including ethical issues related to financial accounting disclosures.

UW medicine has been involved in a U.S. Medicare/Medicaid/TRICARE billing case for 4-1/2 years as a result of a whistle blower complaint. The University of Washington & U.S. Department of Justice are negotiating a precedent setting settlement, reportedly \$30-\$40M. An interesting aspect – one of the principal UW Medicine faculty members, who pled guilty to A charge, as part of his sentence has written a cautionary article in the Journal of Neurosurgery that says ‘criminalization of health care is now a reality and the federal government may identify a faculty member as the responsible party in any healthcare investigation.’

### Summary

Although in the post Enron era, the U.S. and Europe continue to experience mutual fund, stock exchange trading abuses, and multi-national corporate accounting fraud problems.

Knowledgeable observers believe the SOA has proven a catalyst for U.S. Corporate boardroom reform. SOA principles are being adopted by U.S. business. Government, especially state legislatures and attorneys general, are considering similar and expanded reforms. Higher education – health care institutions are considering NACUBO recommendations. In a first year report, SOA co-authors Sen. Sarbanes (D) and Rep. Oxley (R), believe the Act makes a positive contribution to the U.S. economy. See the U.S. House Committee on Financial Services web site <http://financialservices.house.gov>.

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- 3) "Does Government Need A Sarbanes-Oxley Type Reform Act?" Kevin M. Bronner, Public Administration Times, April 2003;
- 4) NACUBO Advisory Report 2003-3, The Sarbanes-Oxley Act of 2002: recommendations for Higher Education;
- 5) UW Medicine Board/Compliance Committee, Resolution – Sarbanes-Oxley Act, dated Sept. 2003;
- 6) Rebuilding Investor Confidence, Protecting U.S. Capital Markets – The Sarbanes-Oxley Act: The First Year – U.S. House Committee on Financial Services, July 29, 2003;
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- 9) The Journal of Neurosurgery/Volume 100:47-55, January 2004, "Errors in compliance with federal rules & regulations relating to healthcare benefits programs: the University of Washington Dept. of Neurological Surgery experience, H. Richard Winn, M.D.

Paul B. Demetriades, B.A., M.P.A., University of WA, retired from the Boeing Company in 1991 and has served as a visiting committee member, UW Evans School of Public Affairs, and an elected City of Medina, WA council member.

